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Consumer Instalment Credit

In order to promote the national defense and protect the national economy the President of the United States on August 9, 1941, issued Executive Order 8843, placing upon the Board of Governors of the Federal Reserve System the responsibility of regulating the extension of consumer instalment credit. The Order recognizes the importance of instalment credit in relation to consumer demand in general and, more specifically, its relation to demand for durable goods manufactured from materials needed for defense. It emphasizes the need for such regulation to promote defense production, to assist in curbing unwarranted price advances and general inflationary tendencies, and to aid in creating a backlog of consumer demand and in restraining the accumulation of a consumer debt structure which might have a repressive effect upon business activity in the post-defense period.

Under the broad authority delegated in the Executive Order, the Board of Governors of the Federal Reserve System has issued Regulation W, imposing limitations upon the terms under which instalment credit is to be extended. The regulation has been drawn with the aid and advice of representatives of the industry and with full consideration of the problems and practices prevailing in this field of credit. It is to be administered on a decentralized basis through the Federal Reserve Banks.

This provision for influencing the extension of instalment credit represents one step toward the broad aim of providing this country with adequate defense against military aggression and against the disruptive influences of economic distortions in employment, income, production, and consumption. The measure is to supple-

ment such other means of promoting defense production and combating inflationary developments as price regulation, priorities, the sale of Defense Savings Bonds, and taxes.

All of these measures entail some form of temporary sacrifice but are designed to protect the security and well-being of the people of the country with a minimum of present and future disturbance. There are three broad aims of national policy in this emergency. The first and most immediate objective is to complete as quickly and as effectively as possible a national defense program of production, the extent of which is unequaled in the history of the world. The second aim is to avoid a disruptive inflation, which might result from current large-scale expenditures for defense and which would seriously impair the real value of individual incomes—particularly those incomes which must be spent in large part for the necessities of life. The third objective might be said to be to conserve a store of buying power for protection against serious deflation when defense needs have been met, when payrolls in defense plants and incomes generally are curtailed.

This protection against aggression, inflation, and deflation can best be achieved on the economic front by maintaining some balance between the supply of available goods and the amount of money and credit that can be used to purchase these goods. The demand for defense materials cannot be reduced, but rather must be expanded as much as our productive and distributive systems will permit. To the extent that consumers' industries, stimulated by active civilian buying, compete with defense industries for materials, labor, plant space, and management, the speed and efficiency of the defense

program are impaired, and costs and prices rise. To the extent that rapidly expanding consumer demand is allowed to exceed the progressively curtailed supply of goods available for purchase, prices will be bid up and the exchange value of money incomes will decline.

If buying becomes excessive and is aggravated further by unlimited expansion of consumer debts, the foundation of recovery from any post-defense deflation is undermined. Incurring debts when income is temporarily expanded impairs buying power in the future, when weekly pay envelopes will be smaller and when each dollar earned will be worth more in terms of goods. As a result, the peacetime products of industry compete with national defense during the period of expansion and are without markets when business and income are no longer stimulated by the production of planes, tanks, ships, and guns.

The excessive use of credit when current incomes are expanded and when the quality of goods is being reduced, not only draws upon future earnings but also makes it difficult to accumulate savings for the time when prices decline and incomes need bolstering.

The broad objectives underlying the regulation of installment credit are to help prevent an overexpansion of consumer demand and of consumer debt, which it may be burdensome to repay later, and to help restrain bidding for consumers' goods to a point consistent with the volume of goods available for purchase. It is also aimed at promoting savings, which can be invested now in the national defense effort through Defense Savings Bonds. Later, when effective defense has been achieved, these savings can be spent for automobiles, refrigerators, and radios. In this way—by promoting budgeting of purchases over periods of expanded and contracted incomes—more facilities can be made available for defense production, depreciation in the real value of weekly earnings can be minimized, and factories, stores, and homes can be kept busy and solvent when defense spending is reduced.

Inflationary conditions. The need for diverting materials, labor, and plants to defense production is apparent, but the necessity for protective measures against inflation is not always so clear. A serious inflation has thus far been avoided, but it is only through farsightedness and full cooperation among producers, distributors, and consumers that this danger can be permanently averted.

The elements of inflation are present. The volume of money in circulation has reached a record high of over \$10,000,000,000 as compared with less than \$4,800,000,000 at the highest point of 1929. Deposits other than those owned by banks have reached an all-time high of over \$65,000,000,000 as compared with only about \$55,000,000,000 in 1929. Bank loans have expanded by nearly \$3,000,000,000 in the past year, a

great part of the gain being in advances to commerce and industry to finance increased business activity, to pay higher prices and wages, and to carry larger inventories. Bank investments have increased over \$3,500,000,000 in this period, representing chiefly funds advanced to the Government to meet the cost of defense. Individual incomes have reached an estimated annual rate of \$89,000,000,000 as compared with only about \$76,000,000,000 in 1940. This is the largest on record in terms of dollars and is even greater when converted into goods and services. Weekly earnings of factory workers have shown large increases; in Pennsylvania the average income of skilled and unskilled workers is now approximately \$33.00 a week as compared with less than \$28.00 a week during the "boom" period in 1929.

At the same time that the supply of money and credit has advanced so sharply, the supply of consumer goods for which this money can be spent has become more and more limited. This country is rich in natural resources, but the unprecedented demands for defense production have absorbed large proportions of the available supply of such key materials as iron and steel, copper, lumber, textiles, and many other products which would otherwise be available for civilian consumption. In the case of such important alloy materials as tungsten and manganese and such other imported goods as tin and rubber, supplies have been curtailed by the lack of shipping space and are threatened further by the rapid spread of hostilities. Plant facilities, of which we had an overabundance in earlier years, are now operating at capacity in basic lines. In key industries, defense and civilian requirements cannot be met by the simple expedient of expanding operations. But growing defense needs must be met, and answering this problem only by building new plants involves too much delay. As a result, priorities, rationing, and direct limitations of output have been employed in lines where shortages are most acute to curtail the production of consumers' goods and thus to make more facilities available for defense.

During the past decade the country has been faced with the problem of unemployment, but in the first year of the defense program nearly 3,400,000 workers were added to non-agricultural payrolls and total employment now is more than 2,000,000 above 1929. Shortages of labor in many areas have caused a heavy migration of workers from farms and non-defense industries into the factories and shipyards that are building equipment for national defense. In the metal trades, our supply of skilled workers was not increased significantly during the period of depression and in consequence is not now adequate for our requirements. Some scarcity of managerial capacity is also in evidence. The problems of maintaining supply lines, of finding workers, of revising production schedules, of utilizing plants most effectively, and of making adjustments to rapidly

changing market conditions are absorbing our managerial force to the limit.

As a result of expanding incomes and growing scarcities, prices have risen. Quotations on basic industrial and agricultural goods have increased 55 per cent since the war started. The general level of wholesale prices has gone up 20 per cent, with some groups of commodities—especially the agricultural—showing substantially greater advances. The cost of labor, as measured in hourly earnings of factory workers, has reached a new peak about one-third above the levels prevailing in 1929. Thus far retail prices and the cost of living have shown smaller increases, but changes in these prices customarily lag, and further advances are to be expected.

The elements of inflation are becoming active and are gathering strength to force prices into an upward spiral. To prevent serious distortions, prompt action on all fronts is imperative, because once inflationary conditions accumulate, the problem of adjustment is out of hand. The remedies must be applied before the acute stage is reached.

The core of the present problem lies in the fact that the Government and civilian consumers want more goods than our industries are able to supply. The goods that the Government wants are for national security and must be provided. The curtailment must be in civilian purchases, primarily in the purchases of durable goods which can be deferred.

Character of instalment credit. A significant part of consumer buying is being done upon the instalment basis. Large cash outlays necessary to purchase such goods as automobiles, radios, and refrigerators have been difficult to make without drawing upon future incomes. Records of instalment purchases reach back to the Colonial Period, but it was not until our industrial system began to produce these expensive durable goods that the practice became widespread. The volume of outstanding consumer instalment credit has grown sharply since the last world war, and currently amounts to nearly \$6,000,000,000.

This amount is small in relation to total national income, but its importance lies in the fact that it is highly concentrated. It is estimated that nearly two-thirds of the furniture and automobiles purchased in this country are bought on instalments. This type of credit is extensively used in the purchase of radios, refrigerators, washing machines, vacuum cleaners, stoves, and a wide variety of other goods which require the same materials as defense equipment. About one out of three families in the United States buys upon the instalment plan, and the greatest use is in the case of families whose incomes are expanding most sharply because of the defense program.

Regulation of instalment credit of a type that shortens terms and increases down payments on purchases of durable consumers' goods will help to conserve individual incomes. This will be an important aid in the recovery of business activity from the reduced levels which may prevail after the defense period. This type of regulation is a relatively painless antidote for inflation because it does not reduce current incomes but only facilitates the more effective, budgeted use of incomes.

Summary of the regulation. Pursuant to the Executive Order, the Board of Governors of the Federal Reserve System has issued Regulation W which in a broad way is outlined below. Copies of the regulation are available at the Federal Reserve Banks, at other banking institutions, and through trade organizations in the Third Federal Reserve District. As the Federal Reserve Banks have been charged with the responsibility of administering the regulation on a decentralized basis, a department of consumer instalment credit has been established in the Federal Reserve Bank of Philadelphia. All inquiries as to clarification of the provisions or compliance with the terms may be addressed to this department. Changes in the regulation may be made from time to time in the light of experience or changing conditions. Any suggestions as to possible constructive amendments may also be made through this Bank.

What types of transactions are covered?

The regulation applies to three types of credit transactions: (a) sales on the instalment plan of durable consumers' goods listed in the table on page 4; (b) cash instalment loans which are in principal amounts of \$1,000 or less or which, regardless of amount, are secured by listed articles; and (c) the discounting or purchasing or lending upon the security of the above types of obligations. Straight demand or time loans which do not involve scheduled repayments, expressed or implicit, are not affected by the regulation.

Who is subject to the regulation?

All persons undertaking in their regular course of business any of the three types of transactions covered by the regulation, whether the person be acting as principal, agent, or broker. Included are banks, finance companies, credit unions, retailers of listed articles sold on the instalment plan, and others similarly engaged.

Registration.

All persons engaged in these types of business are automatically registered to continue this business until December 31, 1941, but all such persons must register not later than the end of the year with the Federal Reserve Bank of the District in which they are located. Registration forms will be available at Federal Reserve Banks and other banks.

General limitations.

The regulation does not eliminate or prohibit any general type of loan, but no instalment credit, whether extended to finance the sale of a listed article or extended in the form of a cash loan, may be for a longer period than eighteen months. Down payments in the case of instalment credit arising from the sale of a listed article must be in accordance with the schedule shown in the list of articles. The instalment payments must be in substantially equal amounts and must be made at regular intervals not exceeding one month, except under certain conditions, such as when incomes are seasonal in character. After January 1, no payments on an instalment contract may aggregate less than \$5.00 a month. After October 1, transactions must be evidenced by written records showing the essential features of the transaction.

Down payments on automobiles.

In the case of automobiles, the down payments must be equal to at least one-third of the bona fide cash purchase price including advertised factory delivered price, freight, taxes, delivery charges, and accessories purchased with the automobile. All or part of this down payment may be in the form of an allowance made in good faith for a traded-in automobile.

Down payments on listed articles other than automobiles.

Down payments on refrigerators, radios, furniture, and other listed articles except automobiles are to be calculated in accordance with the terms specified on a basis price which represents the cash purchase price minus the allowance for traded-in articles. In these cases, the down payments must be in cash.

Provisions for changing terms on instalment contracts.

If, because of an unforeseen or uncontrollable contingency, observance of the allowable terms of an instalment contract would work undue hardship upon the obligor, these terms may be extended or otherwise liberalized only if the creditor accepts in good faith a signed "statement of necessity" from the obligor setting forth the essential features of the difficulty. The terms cannot be altered beyond the maximum allowable on the original extension by any addition and consolidation of debt or by any refunding of debt, whether held by one creditor or more than one, unless a statement of necessity is accepted.

Exemptions from the regulation.

The following types of instalment loans may be granted on terms other than those prescribed in the regulation: loans secured by first liens on improved real estate, loans in excess of \$1,000 for improvements to real estate which are not primarily for the purchase of listed articles, loans to students for educational purposes, loans to pay for medical and related services which

cannot be otherwise paid for without undue hardship, certain loans which promote the defense program, credit to finance retail sales repayable in three months, loans to finance dealer floor plans, loans to finance the purchase of demonstrators by automobile salesmen, loans to businesses secured by collateral comprising consumer instalment obligations, and certain farm and business loans.

Outstanding contracts.

The regulation does not apply to contracts outstanding before the effective date unless such contracts have been extended or revised after the effective date.

Effective date.

The regulation became effective September 1, 1941, except that provisions dealing with statements of transactions will not become effective until October 1, the provisions dealing with additions, renewals, and revisions will not become effective until November 1, and the provisions specifying minimum monthly payments will not become effective until January 1, 1942.

LIMITATIONS UPON DOWN PAYMENTS AND MATURITIES

Articles of Consumers' Durable Goods (Whether new or used)	Maximum Maturity in Months	Maximum Credit Value in Per Cent of Basis Price
Group A		
1. Automobiles (passenger cars designed for the purpose of transporting less than ten passengers, including taxicabs).....	18	66 $\frac{2}{3}$
Group B		
1. Aircraft (including gliders).....	18	66 $\frac{2}{3}$
2. Power driven boats, and motors designed for use therein, other than boats or motors designed specifically for commercial use.....	18	66 $\frac{2}{3}$
3. Outboard boat motors.....	18	66 $\frac{2}{3}$
4. Motorcycles (two or three-wheel motor vehicles, including motor bicycles).....	18	66 $\frac{2}{3}$
Group C		
1. Mechanical refrigerators of less than twelve cubic feet rated capacity.....	18	80
2. Washing machines designed for household use.....	18	80
3. Ironers designed for household use.....	18	80
4. Suction cleaners designed for household use.....	18	80
5. Cooking stoves and ranges with less than seven heating surfaces.....	18	80
6. Heating stoves and space heaters designed for household use.....	18	80
7. Electric dishwashers designed for household use.....	18	80
8. Room-unit air conditioners.....	18	80
9. Sewing machines designed for household use.....	18	80
10. Radio receiving sets, phonographs, or combinations.....	18	80
11. Musical instruments composed principally of metals.....	18	80
Group D		
1. Household furnaces and heating units for furnaces (including oil burners, gas conversion burners, and stokers).....	18	85
2. Water heaters designed for household use.....	18	85
3. Water pumps designed for household use.....	18	85
4. Plumbing and sanitary fixtures designed for household use.....	18	85
5. Home air conditioning systems.....	18	85
6. Attic ventilating fans.....	18	85
7. New household furniture (including ice refrigerators, bed springs and mattresses but excluding wall coverings, draperies and bed coverings).....	18	90
8. Pianos and household electric organs.....	18	90
Group E		
1. Materials and services (other than materials listed in Group C or D) in connection with repairs, alterations or improvements upon urban, suburban, or rural real property in connection with existing structures provided the deferred balance does not exceed \$1,000..	18	No limitation

(The supplement to the regulation fixes the limitations and provides bases for calculating credit values.)